

No. 10759.

IN THE  
United States Circuit Court of Appeals  
FOR THE NINTH CIRCUIT

— 4 —  
CHIQUITA MINING COMPANY, LTD.,  
*Petitioner,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

—  
CLOSING BRIEF OF PETITIONER.  
—

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## CLOSING BRIEF OF PETITIONER.

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### Foreword.

For the sake of clarity, we shall answer respondent's brief by referring to the various subdivisions thereof and shall indicate by appropriate page references the portion of that brief which is being answered under the designated title or subtitle.

Before proceeding, however, to a discussion of the matters contained in respondent's brief we wish to demonstrate the simplicity of the issue presented to the Tax Court on the question of depletion, by the application of the provisions of Section 112(b)(5) of the Revenue Act of 1928, C. 852, 45 Stat. 791, set forth on page 34 of

respondent's brief. We quote the portion of the section referred to:

"SEC. 112. RECOGNITION OF GAIN OR LOSS.

\* \* \* \* \*

(b) *Exchanges solely in kind.*

\* \* \* \* \*

(5) *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; *but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.*" (Emphasis ours.)

Prior to the acquisition by petitioner of the mining properties from Jack H. Smith and Otto F. Schwartz, the entire ownership of the mining properties vested in them alone. Immediately upon their conveyance of the mining properties to petitioner, in legal contemplation the 500,000 shares of the capital stock of petitioner were deemed to be issued. Since no other shares of the capital stock were then outstanding, this block of 500,000 shares represented the total stock ownership of petitioner corporation. At no time did Jack H. Smith and Otto F. Schwartz own more than 250,000 shares of the capital stock of Chiquita Mining Co., Ltd. In other words, at no time after the conveyance of the mining properties,

did they own equitably through stock ownership (or otherwise), more than a half interest in the mining properties which had been conveyed by them to petitioner and which constituted the sole assets of the corporation at the time.

The simple issue thus presented to the Tax Court was this: Was the amount of stock and securities received by Jack H. Smith and Otto F. Schwartz substantially in proportion to their interest in the mining properties prior to the exchange?

In determining the amount of stock received by them it is obvious that this could be proved not only by the contracts which in their nature specified *what should be done in the future* but also by other evidence and testimony proving *what had actually been done in the past*. As we have shown in our opening brief and shall likewise show herein, the Tax Court arbitrarily restricted the proof to proof of contracts rather than to permit competent proof of the ultimate fact which is prescribed in the section quoted above, as the test for determining whether the transaction in question was a taxable transaction.

### Opinion Below.

(Resp. Br., p. 1.)

Respondent is correct in stating that the opinion of the Tax Court [R. 23-26] is unreported.

### Jurisdiction.

(Resp. Br. p. 1)

The statement of jurisdictional facts contained in respondent's brief is likewise correct.

### Questions Presented.

(Resp. Br. pp. 2 and 3.)

The *ultimate* question whether the case should be remanded to the Tax Court for further hearing on the issue decided adversely to the taxpayer, is in accord with petitioner's understanding of that question. However, we do not agree with certain details, which in his statement of *subsidiary* questions, respondent has either added to or omitted from the questions which petitioner raised in its opening brief.

It is apparent from a reading and comparison of the questions raised in the opening brief and those set forth in the brief of respondent that respondent has not given a direct answer to our questions. Respondent has, on the contrary, taken the questions generally, as raised by petitioner, and revised them to make them answerable. This will appear from what we shall say hereinafter.

One thing particularly is noteworthy. In order to justify the rulings of the Tax Court respondent now attempts to avail himself of objections that are made here for the first time and were not made during the hearing. Furthermore, such objections if they had been made at the hearing could easily have been obviated by petitioner at the time.

## **Statutes and Rules Involved.**

(Resp. Br. p. 3.)

Respondent refers to certain statutes and rules set forth on pages 34 to 37 of his brief. No comment concerning them is required at this point, but we shall discuss them, when and if necessary later in this brief.

## **Statement.**

(Resp. Br. pp. 3 and 4.)

This statement of respondent is also correct.

### **1. Motions for Continuance.**

(Resp. Br. pp. 4 to 7.)

The statement of respondent of the preliminaries leading up to the ruling of the Tax Court on the motion for a continuance requires no comment. Certain portions of the Court's own statements, however, on pages 6 and 7 of respondent's brief, definitely show how petitioner was shuttled about from one type of proof to another. By this we mean, that when petitioner attempted to prove the ultimate fact in issue by one kind of evidence, an objection thereto was sustained and petitioner was told in effect, as stated by respondent himself on page 24 of his brief, that "other competent evidence and testimony were available." When petitioner then proceeded to avail itself of certain of that "other competent evidence and testimony," it was again met with an objection which was likewise sustained. Every objection to available evidence was sustained, and petitioner was forced to understand that the ultimate fact in issue could be proved in only one way and that was by evidence which was *unavailable* at that time.

The first remark of the court to which we desire to call attention is the following:

“This case has been set a *long time*.”

On August 26, 1942, the case was set for hearing for the first time. The actual hearing date was fixed for October 12, 1942. The “long time” to which the judge of the Tax Court referred amounted exactly to forty-seven days. In the light of our experience with the trial calendars of other courts, we would say that this not only was not a long time between the setting and the trial but an unusually short time. This, we feel, is a very forceful example of the standards that were set up during the hearing with which petitioner was obligated to conform.

Another statement which is interesting when we consider the later rulings of the Tax Court is the following:

“Now, all we want to know in this case is how a certain transaction was carried (out), *not the details*, but the *broad general principles*, to see whether you come within the Revenue Act.”

Here the Tax Court definitely indicated that specific details were not of importance but that broader questions were involved. By its next statement it clearly showed that because of the broadness of the general principles involved, the proof thereof would not be limited to the testimony of Maxfield and Wilton but that there might be any number of people who could testify to the same effect. We refer to this language of the Tax Court:

“Now, there is no showing—there might be any number of people who might know about it. *I would think any person who had anything to do with it would know about it.*”

The latter sentence is most interesting when we consider that in attempting to determine the proportionate number of shares of the capital stock of petitioner that had been received by Jack H. Smith and Otto F. Schwartz, the Tax Court rejected the testimony of a certified public accountant who had made an exact audit of all of the books and records of petitioner from the time of its incorporation to the date of the hearing.

We certainly had the right to take the Tax Court at its word. We did believe at this point in the proceedings, that the Tax Court would not thereafter exclude "other competent evidence and testimony" that "were available," as stated by respondent in his brief. Had such other competent evidence and testimony been admitted, no prejudicial effects could have resulted from the failure of the Tax Court to grant petitioner's motion for a continuance. That evidence, however, having been excluded, the prejudicial effect of the Court's ruling in this first instance becomes at once apparent.

The concluding statement of respondent under this point, that the witnesses had been called when the depletion issue had not been entered, discounts itself. The record clearly shows that both witnesses refused to give any further testimony. The law certainly does not require idle acts and neither should the Tax Court. Respondent cannot seriously contend that the two witnesses, if called later when the depletion issue had been reached, would have testified concerning it.

## 2. Prior Bureau Rulings.

(Resp. Br. pp. 7 and 8.)

Respondent's statement with reference to the specific portions thereof to which attention is called, is substantially correct as far as it goes. There is, however, an inaccuracy therein. Respondent states on page 7 of his brief:

“These prior determinations apparently involve the tax on the transfer of securities. [R. 60-61.]”

There were two such determinations. Neither involved the determination of the tax due on the TRANSFER of securities. The first deficiency that was assessed against petitioner related to the tax due on the ISSUANCE of securities. In that instance which occurred in May, 1933, petitioner was penalized for having failed to purchase and cancel documentary stamps due upon the issuance of the 500,000 shares of its capital stock as the consideration for the mining properties in question, even though CERTIFICATES representing only approximately one-third of the number of shares above mentioned had been issued and delivered. Furthermore, petitioner was compelled to purchase and cancel documentary stamps upon the remainder of the 500,000 shares, for which certificates had not previously been issued. The government took the position, which is undoubtedly correct, that when the mining properties were conveyed to the corporation, the entire consideration therefor, to wit, 500,000 shares of petitioner's capital stock, were *ipso facto* issued and delivered, even though CERTIFICATES therefor had not actually been issued or delivered. The Bureau of Internal Revenue in assessing the deficiency and in penalizing petitioner in addition thereto, definitely held and determined under the procedure

followed by it with reference to documentary stamp taxes, that the consideration for the transfer to petitioner of the mining properties in question, was 500,000 shares of petitioner's capital stock. That determination has never been vacated, modified or in any way repudiated, in so far as petitioner's liability for that type of tax, is concerned.

The second instance occurred approximately in July or August of 1934. At that time the Bureau investigated the amount of documentary stamp taxes that had been affixed to the deeds conveying the mining properties to petitioner. The investigation concerned itself directly with the amount of consideration paid by the corporation for the properties in question. The Bureau of Internal Revenue upon the conclusion of its investigation definitely determined that the total consideration paid by petitioner for said mining properties was the sum of \$500,000.00. Upon that basis the Bureau assessed a deficiency which was paid by petitioner. At that time petitioner voluntarily adopted the conclusions and determinations made by the Bureau of Internal Revenue. Incidentally, this second determination was consistent with the former determination and, in effect, ratified it.

With reference to the taxes there paid, those conclusions and determinations have at all times been adhered to by petitioner and respondent. It is only now, when those conclusions and determinations will lessen the taxes to be paid by petitioner that respondent attempts to repudiate its prior findings of fact and conclusions of law.

### 3. Testimony of Mr. Steffes.

(Resp. Br. pp. 8 to 12.)

The recital contained in this portion of respondent's brief is substantially correct but the strength of petitioner's position with reference to laying a foundation for the use of secondary evidence is more apparent from the statement made by the counsel-witness which is set forth on page 20 of our opening brief. We refer to the following:

"Mr. Steffes: I would like to make a showing as the reason for the absence of documentary testimony at this time—well, I would like to make that showing so as to lay the foundation for the production of secondary evidence in lieu of such primary evidence."

He was told to proceed by the judge, but his statement was interrupted by counsel for respondent who, in effect, at this point stipulated to the introduction of secondary evidence. This interruption is disclosed by the incomplete sentence at the end of the first paragraph on page 12 of respondent's brief.

After Mr. Steffes had then stated to the court and counsel that the secondary evidence would be his personal knowledge of those documents which he personally prepared and some of which he personally turned over to Mr. Crupf of the S. E. C., he was again interrupted, this time by the Court. Respondent shows this interruption in the last paragraph on page 12 of its brief. We do not agree with counsel that the portion of the record on pages 98 to 101 of the Transcript of the Record limited this offer of proof of secondary evidence to the depreciation issue. It is true that Mr. Steffes at that time felt that petitioner had not finally closed its case on the depreciation issue, but it is equally true that the documents in question which

were unavailable at the time related to both issues. It will be observed from a reading of the Transcript, that no statement was made nor was any discussion had which would limit this testimony to the issue alone which was decided in favor of petitioner.

The portion of the record to which respondent refers indicates that it consisted of an academic discussion between the court and counsel for petitioner as to what petitioner would have to prove. Counsel for petitioner correctly stated the issue with reference to depreciation. It is quite apparent that the Court was not then interested in this issue but was interested in the issue of depletion. We believe that respondent will concede that in the latter part of the discussion, when explaining the issue with reference to depletion, counsel for petitioner gave a correct explanation. That counsel for petitioner was referring to both issues clearly appears from the statement made by him to the Court on page 101 of the Transcript of the Record.

“Mr. Steffes: Well, I would like to make this comment, because I feel that here is a misunderstanding, that that refusal to testify or to offer evidence by these two witnesses goes to the question of depreciation as well as the question of depletion, and I make that with all due respect to the Court, having a personal knowledge of the facts upon which that request and motion is made.”

That statement was shortly thereafter followed by this explanation given by counsel to the effect that he did not at that time believe that the hearing had arrived to the determination of the issue of depletion. We refer to the

following statement on the same page of the Transcript of the Record:

“Mr. Steffes: I didn’t think we had entered it yet, your Honor. My understanding was that the witnesses were called by Mr. Sandrich on the question of depreciation, and I still feel that my recollection of the record is correct, and that during that portion of the hearing both witnesses and each of them refused to testify on their constitutional grounds. Now, if that has been disposed of, I have no alternative but to proceed with the question of depletion.”

There certainly is nothing in the portion of the record designated by respondent or any other part of the record to the effect that the testimony of Mr. Steffes was limited and restricted by petitioner to the issue of depreciation.

#### 4. Statements by Mr. Sandrich and Offer of His Papers.

(Resp. Br. pp. 13 to 16.)

Respondent’s statement and quotation from the record in this portion of his brief are likewise substantially correct. The preliminary statement made by Mr. Sandrich, the certified public accountant, which was evidently accepted as true by both the Court and counsel for respondent definitely showed that certain records which he had set up for the corporation approximately two and one-half years before the notice of deficiency was mailed to petitioner on May 1, 1941, constituted the *permanent records of the corporation*. Those records were in detail and were offered for the inspection of counsel for respondent. An offer was later made to introduce those records *in toto*.

It will be observed that no objection was made nor did the Tax Court reject the evidence on the ground that the records were not actually in the court room. It can be assumed that such records were quite voluminous and where they could have been produced in the court room within ten minutes, as stated, certainly there is no merit in the contention of respondent on these proceedings for a review that the records were not actually in the court room. Had such objection been made at the time of the hearing, petitioner before the close of the hearing, could and would have actually produced the records in the court room and renewed its offer to introduce them.

#### 5. Motion to Reopen the Cause.

(Resp. Br. pp. 16 to 18.)

This statement, in so far as it goes, and the portion of the affidavit of the certified public accountant on the motion to reopen the cause require no comment at this point. They too are substantially correct in so far as they go.

#### Summary of Argument.

(Resp. Br. pp. 18 to 20.)

Since we shall answer each of the points which are briefly alluded to in the summary, when discussing the various points in detail later in this brief, we shall not make any comments with reference to this summary of the argument except the following:

Here again respondent states on page 19 of its brief that in addition to the testimony of Maxfield and Wilton "other competent evidence *and testimony* was available." Later in his summary respondent attempts to prove that such other competent evidence and testimony was in fact incompetent and inadmissible.

## ARGUMENT.

### Respondent's Contention That the Taxpayer Is Not Entitled to a Second Hearing Before the Tax Court.

(Resp. Br. pp. 21 to 23.)

Since this contention, if correct, follows as a conclusion from the arguments made under the succeeding five points discussed on pages 23 to 33 of respondent's brief, we shall answer respondent's contentions set forth on pages 21 to 23, after we have answered the subsequent points in its brief which are the premises upon which respondent bases his conclusions.

#### I.

### Respondent's Contention That the Tax Court Did Not Err in Refusing a Continuance.

(Resp. Br. pp. 23 to 25.)

Two of the three grounds urged by respondent which are claimed to justify the court's denial of a continuance after Maxfield and Wilton had refused to testify are that "the case had been set for hearing for a long time" and "other competent evidence and testimony was available."

The determination by this court whether the period of forty-seven days between August 26, 1942, and October 12, 1942, constitutes a "long time" requires no argument or discussion. We submit that since this was the first hearing that was ever set, the case had not "been set for hearing for a long time."

In advancing his second ground, respondent refers both to EVIDENCE and TESTIMONY. Respondent cannot now be heard therefore to state that the competent evidence to which he referred, consisted only of the documentary evidence which petitioner was unable to produce during the hearing. The only authorities cited in support of respondent's position are cited on page 24 of respondent's brief. We shall discuss and distinguish each of the two authorities cited.

Respondent cites the case of *Hobby v. Commissioner*, 97 F. (2d) 731, 732 (C. C. A. 5th) in support of his contention that the Tax Court did not err in refusing a continuance. The third reason given by respondent for the correctness of the Tax Court's ruling on the application for a continuance is "other competent evidence and testimony were available." In the cited case it was held that there was no showing with reference to the testimony of absent witnesses "that the same facts could not be proven by other witnesses who were available."

We concede that at the hearing "other competent evidence and testimony were available"; however, as we have pointed out, that competent evidence and testimony was rejected by the Tax Court. It is the rejection of that evidence which magnifies the abuse by the Tax Court of the discretion vested in it. Had such "other competent evidence and testimony" been admitted, petitioner would have unanswerably proved its case and petitioner would not now complain of its inability to utilize the testimony of the witnesses Maxfield and Wilton.

Respondent also cites at this point 9 Mertens, Law of Federal Income Taxation (1943), Sec. 50.52. After quoting Rule 20, the first statement made under this section is as follows:

*“Although the Board has been extremely liberal in granting extensions, it will exercise its discretion to refuse applications made for dilatory purposes, and where a proceeding has been at issue for a long time the Board may, in order to expedite its work, refuse continuance.”*

The record in this case discloses that the hearing in question was the very first hearing ever set in this matter. Furthermore, the hearing was set on August 26, 1942, and on that date the Tax Court fixed the date of hearing as October 12, 1942. Only forty-seven days elapsed between those two dates. The matter was at issue since September 25, 1941, when the answer of respondent was filed, but no steps were taken by respondent to have the matter placed on the Los Angeles calendar until August 26, 1942, as stated above. Certainly there is nothing in the record which indicates any unusual delay and most assuredly there is nothing showing that the request for a continuance was made for the purpose of delay only. Petitioner was attempting to get the truth before the Tax Court, and even a slight display of liberality on the part of the Tax Court would have accorded to the taxpayer an opportunity to have the question, presented in good faith by it, determined on its merits,

Respondent next makes the following contentions on page 24 of his brief:

“As further support for the refusal to grant a continuance, we desire to emphasize, contrary to the taxpayer’s contention (Br. 11) that the refusal of Maxfield and Wilton to testify was *not* on the ground that their testimony might tend to incriminate them. [R. 78, 81, 83.] Unless they expressly claimed their constitutional privilege, the taxpayer could have insisted that they be required to testify. This was not done. Instead the witnesses were led up to the point where they stated they would refuse to testify and were then excused by taxpayer’s counsel.”

Once again respondent urges an objection in these proceedings on review, which was not made at the hearing, and which, if made, could and would have been remedied by petitioner. Certainly respondent does not seriously assert at this time that the witnesses would have testified if petitioner had “insisted that they be required to testify.”

Respondent then draws this conclusion:

“From what took place, it is not unreasonable to infer that the witnesses were called only to set the stage for a request for additional time, in order that taxpayer’s counsel might obtain the documentary evidence which Mr. Sandrich had relied upon Mr. Steffes had failed to produce. [R. 31-32.]”

In drawing this conclusion respondent obviously overlooks the fact that at this point in the proceedings, peti-

tioner had not yet been given to understand that its proof would be restricted to the documentary evidence to which respondent refers. Petitioner was certainly lead to believe by the remarks of the judge presiding, that there were any number of witnesses that could testify to the same facts that were desired to be elicited from the two witnesses who refused to testify.

Respondent concludes his argument under this point with the alternative contention that petitioner was not injured since these witnesses were placed on the stand to testify concerning the depreciation issue which was decided in favor of petitioner. It is true that there were certain items relative to the depreciation issue which were exclusively within the knowledge of the witness Maxfield. But the fact that he had such exclusive knowledge of certain facts relating to the issue of depreciation, did not prevent him from having a knowledge concerning facts pertaining to the issue of depletion. When we consider that Maxfield, as the *CHIQUITA MINE SYNDICATE*, acquired one-half of the stock that was issued in payment for the mining properties that were conveyed by Jack H. Smith and Otto F. Schwartz to petitioner, it is absurd to suggest at this time that petitioner was not prejudiced by the refusal of a continuance. As we remarked above, the prejudicial effect of the court's ruling was greatly magnified by its subsequent rulings in rejecting various types of evidence offered by petitioner on the simple issue that was presented to it for determination.

II.

**Respondent's Contention That the Tax Court Did Not Err by Refusing to Admit Evidence of Prior Determinations of the Bureau of Internal Revenue.**

(Resp. Br. pp. 25 to 27.)

In his first paragraph under this point respondent emphasizes his contention that no formal offer of this evidence was made. If there had been any doubt whatsoever concerning the attitude of the Tax Court with reference to evidence of prior determinations of the Bureau of Internal Revenue, respondent might with good grace be heard to say that petitioner should have formally offered the evidence in question. In view, however, of the emphatic statement of position by the presiding judge there was no room whatsoever left for any doubt. Any more formal offer than that which was actually made might have antagonized the Court, and counsel for petitioner, in view of the court's previous remarks, certainly did not desire to incur the further displeasure of the Court.

Thereafter, on page 26 of respondent's brief, the following statements and citations of authorities appear:

"It is utterly fantastic to contend that the Commissioner is estopped to determine a deficiency in income and excess profits taxes for the taxable years here involved because in 1933 and 1934 deficiencies in documentary stamp tax may have been found to exist. (Taxpayer's Br. 14-17, 36-37.) Such evidence is clearly irrelevant, for it has been held time and again that the Commissioner is not estopped by his prior determinations. See, *e. g.*, *Burnet v. Porter*, 283 U. S. 230; *Tonningsen v. Commissioner*, 61 F. 2d 199 (C. C. A. 9th). The Tax Court would not have erred if it had excluded such evidence."

In the case of *Burnet v. Porter*, the Commissioner of Internal Revenue had first approved a deduction and allowed a claim for refund and later reopened the case, disallowed the deduction and redetermined the tax. As pointed out in the decision under the applicable statutes mentioned therein, the decision had not attained any degree of finality. In the present case, the determination of the precise question at issue here, by the Bureau of Internal Revenue particularly when it fixed the amount of documentary stamp tax due the government when petitioner acquired the mining properties in question, has never been vacated or modified. Certainly, the additional tax paid by petitioner at that time has never been refunded to it. The rejection of the evidence in this case, it will be observed, was not predicated upon the ground that the prior determinations were not final under Federal statutes, but generally that any and all evidence of prior acts or determinations of the Commissioner were immaterial. In other words, the evidence was excluded on the ground of immateriality and not upon the ground of insufficiency with reference to the finality of the prior determination or determinations.

In the cited case the court stated that the United States Circuit Court of Appeals for the Third Circuit was clearly right in sustaining the power of the Commissioner upon the authority of *McIlhenny v. Commissioner of Internal Revenue* (C. C. A. 3d C.), 39 F. (2d) 356. In the latter case the sole question which was involved was whether the Commissioner should have followed certain statutory provisions mentioned in the decision or whether the Commissioner was bound by Commissioner's General Order of

January 20, 1923, which was obviously in conflict with the statutory provisions above referred to. That situation, of course, does not exist in the present case, since not later than 1934, both the taxpayer and the Commissioner for the purpose of fixing one type of government tax have adopted and at least by acquiescence have ratified the fixing of a certain consideration as the cost price to petitioner of the mining properties which it acquired.

In the case of *Toitningsen v. Commissioner*, 61 F. (2d) 199 (C. C. A. 9th), the same situation existed as in the case of *Burnet v. Porter*, *supra*. What we have said above is equally applicable to the decision by this court in the case last cited. There is one further distinction that applies here as well as to the decisions in the other cases mentioned in the opinion, and that is this: Petitioner is not attempting to rely upon a previous determination of the *amount of taxes due* from it to the government. It is relying, however, upon a former determination concerning a factual situation and the legal effect thereof, which constituted the basis of assessing a deficiency tax against petitioner which has never since been disturbed. We are not attacking the power of the Commissioner to redetermine a tax in those cases which are specifically provided for by statute. We do contend, however, that the same principles of equity and good conscience apply to a Commissioner of Internal Revenue in his official capacity as would apply to him in his private dealings in his individual capacity. To be more explicit, we feel that the government, acting through the Commissioner of Internal Revenue, should not be permitted in order to collect a greater tax, to adopt one theory and then later likewise in order to collect a greater tax, adopt the opposite theory. When he has fixed a standard in one case

by which the taxpayer has been bound and that standard in the transaction where it was fixed and established, has never been changed, the Commissioner of Internal Revenue in equity and good conscience should likewise be bound by that standard for the purpose of fixing other kinds of taxes. We, of course, further contend that had the Tax Court not rejected all the "competent evidence and testimony" that were available at the hearing, the proof would have demonstrated that the Bureau of Internal Revenue was correct in the first instance in fixing the standard as to the price paid by petitioner for its mining properties.

If the evidence concerning the two prior determinations of the Bureau of Internal Revenue was inadmissible as proof of an estoppel against respondent, it may still serve a useful purpose in these review proceedings. In the present hearing, petitioner was attempting to prove the very thing that the Bureau of Internal Revenue had succeeded in proving to petitioner, in order to collect additional taxes and a penalty from petitioner. Since respondent was successful on these former occasions, it is reasonable that petitioner would likewise have been successful in proving by means of the other competent evidence and testimony that were available, that the transaction in question was a taxable transaction, since Jack H. Smith and Otto F. Schwartz had not received for the mining properties shares of the capital stock of petitioner, the amount of which was substantially in proportion to their interest in those properties prior to the exchange.

III.

**Respondent's Contention That the Tax Court Did Not Err by Excluding the Testimony of Mr. Steffes as to His Recollection of the Contents of Certain Documents.**

(Resp. Br. pp. 27 to 29.)

The questions which respondent attempts to raise indicating that the documentary evidence which petitioner claims was unavailable at the hearing, was in fact available, are certainly moot. Any and all such questions were effectively eliminated from further consideration by the stipulation of respondent at the hearing substantially to the effect that secondary evidence could be introduced by petitioner without the necessity of laying a further foundation therefor. This is especially true when we consider that counsel for petitioner was interrupted by counsel for respondent when the former was proceeding to lay a proper foundation for the introduction of secondary evidence.

On pages 27 and 28 of his brief respondent makes the following contentions:

"The original books and documents were the best evidence and they should have been produced. Secondary evidence in lieu of the best evidence was properly excluded. See 9 Mertens, Law of Federal Income Taxation (1943), Secs. 50.76, 50.78; 4 Wigmore, Evidence (3rd Ed.), Sec. 1177 *et seq.*"

Under Sec. 50.6 in 9 Mertens, Law of Federal Income Taxation (1943), the following statement appears:

"The Board has accepted work sheets and copies from accountants who made a monthly audit for the purpose of establishing business income where the

books were lost; being the only evidence, the Board said that became the best evidence.”

It will be recalled that here the certified public accountant had made a complete audit and examination of all of the books and records of petitioner and in lieu of formal books which were not kept by the company at first he had substituted his work sheets or audit spread as the permanent records of petitioner. Those records were at all times available, but as shown in our opening brief, the Tax Court definitely refused to admit either the records or evidence by the certified public accountant of the contents of those records.

In note 35 on page 312 of the cited work the following appears:

“But see Murray Humphreys, 42 B. T. A. 857, in which oral testimony concerning the contents of books which could not be found was admissible. This decision has been aff’d in 125 F. 2d 340 (C. C. A. 7th, 1942).”

The reference to 4 Wigmore, Evidence (3rd Ed.), Sec. 1177 *et seq.*, is, of course, a general reference to the *best evidence* rule. We do not know to which paragraph or paragraphs among the numerous paragraphs appearing in the work, respondent specifically desires to call attention. Suffice it to say that there is nothing in Wigmore’s work on Evidence which upholds the rejection of secondary evidence under circumstances such as exist here, where respondent stipulated to the use of such secondary evidence.

On page 28 of his brief respondent next attempts to explain away the stipulation of counsel for respondent

during the hearing consenting to the introduction of secondary evidence. Respondent states: "Counsel for Commissioner did make a highly ambiguous statement."

That concession by respondent alone should entitle petitioner to the benefit of the stipulation for which it contends. Counsel for petitioner was led to believe and at all times thereafter was permitted to believe that respondent had waived the laying of a further foundation for the introduction of secondary evidence. It ill becomes respondent at this late stage of the proceedings to maintain that no such stipulation was intended. After counsel for respondent had obviously expressed acquiescence and consent to the introduction of secondary evidence without the necessity of laying a further foundation therefor, counsel for petitioner went on to explain that the secondary evidence would consist of his personal knowledge of certain documents which he had personally prepared.

After the interruption by the judge in the nature of an academic questioning of counsel for petitioner concerning the issues to be proved at the hearing, the proceedings were summarily terminated. Respondent claims that Mr. Steffes did not subsequently attempt to testify. It is difficult to express the feelings of counsel for petitioner in the condition of his then health, when confronted with the insurmountable obstacles presented by the rejection of all the "other evidence and testimony that were available" and the restricting of the proof to evidence which was then unavailable and the production of which in fact, had been waived by counsel for respondent.

It is our sincere opinion that this court is concerned with substance and not with mere technicalities of form,

IV.

**Respondent's Contention That the Tax Court Did Not Err by Excluding Testimony of Taxpayer's Accountant as to the Contents of Taxpayer's Books or in Excluding Accountant's Working Papers in Lieu of Taxpayer's Books.**

(Resp. Br. pp. 29 to 31.)

Once again respondent urges a technical objection as to the form of the offer. The record in this case shows clearly what transpired. The judge indicated forcefully and definitely his attitude toward the evidence with reference to the books of Mr. Sandrich, the certified public accountant. The evidence without any contradiction showed clearly that the records in question, long before these proceedings were commenced, had become the permanent records of petitioner. The detailed audit made by a competent certified public accountant are just as reliable, if not more reliable, than a formal set of secondary entries made by a bookkeeper. The purpose in making the audit was manifestly to ascertain, verify and certify with reference to the items constituting the business affairs of the corporation. It is our opinion that such audit records which have been adopted by the corporation as its own permanent records, long before any tax question arose, are deserving of the greatest weight.

On pages 29 and 30 of his brief respondent makes the following assertion and cites certain cases in support thereof:

“In any event, testimony by Mr. Sandrich as to the contents of taxpayer's books and records would have been properly excluded, if offered. The original books, records and documents, although admittedly

in existence, were not offered in evidence and Mr. Sandrich had not been engaged to audit the taxpayer's books until several years after the transaction involved took place. [R. 69-70, 72-73.] His testimony was clearly incompetent. See, *e. g.*, *Consolidated Coke Co. v. Commissioner*, 70 F. 2d 446 (C. C. A. 3d); *Greengard v. Commissioner*, 29 F. 2d 502 (C. C. A. 7th); *Chicago Railway Equipment Co. v. Commissioner*, 4 B. T. A. 452."

The case of *Consolidated Coke Co. v. Commissioner*, 70 F. (2d) 446 (C. C. A. 3rd), is certainly not in point. In that case the taxpayer had destroyed certain original resolutions and attempted to introduce copies thereof. The Board of Tax Appeals refused to admit the copies. In holding that the Board was justified under the circumstances in not accepting the explanation for the destruction of the original resolutions "after the notice of deficiency in this proceeding had been initiated," the Circuit Court of Appeals for the Third Circuit cited Wigmore on Evidence (2d Ed.), Sec. 1198. That section reads as follows:

"Sec. 1198. SAME: INTENTIONAL DESTRUCTION BY PROPONENT HIMSELF. If it should appear that the party desiring to prove a document had himself destroyed it, with the object of preventing its production in court, the evidence of its contents, which he might then offer, could properly be regarded as in all likelihood false or misleading (*ante*, Sec. 291). It is with this extreme case in mind that a few courts have inconsiderately laid down an unconditional rule that the proponent's intentional destruction of the document bars him from evidencing its contents in any other way: . . ."

Certainly there is nothing in this record which indicates any intentional destruction of records.

The holding in the case of *Greengard v. Commissioner, supra*, is not decisive since the facts in that case are entirely different from those existing here. The records which were there excluded had not been adopted by the taxpayer as permanent records long prior to the mailing of the deficiency notice, as in the instant case. A reading of the opinion in that case discloses its inapplicability without further argument.

The obvious distinction in the case of *Chicago Railway Equipment Company v. Commissioner*, 4 B. T. A. 452, is that "the (taxpayer's) auditor undertook to testify as to what the company's books contained relative to the original cost of the various properties owned by it" and "the books of account were not produced at the hearing nor were their contents offered in evidence in a competent manner." In the present case the entire records of petitioner reflecting each item in detail since the organization of the corporation were offered *in toto*, and the certified public accountant, who was also acting as co-counsel for petitioner, definitely indicated his intention to testify when he asked the following question of the court:

"Your Honor, isn't it a fact that a Certified Public Accountant having made a detailed audit of a concern, that his evidence and his findings are competent evidence as to sum totals and a general exposition of the evidence?"

At this point counsel for respondent made this assertion:

"We have no such problem before the Board. We have no accounting problem involved here."

To this the certified public accountant replied:

“Mr. Sandrich: We have a question of fact involved, questions which I myself, as the auditor, as a certified public accountant, went into and verified and built up my records therefrom, and it seems to me that those would be competent evidence.” [Tr. p. 104.]

It is quite obvious that petitioner was not attempting to offer the testimony of the certified public accountant without at the same time producing for the benefit of counsel for respondent and in court, the records of petitioner to which his testimony related. The court as it indicated was not interested in the details concerning numerous certificates each representing different amounts of shares of stock, but the court was primarily interested in the number of shares which Jack H. Smith and Otto F. Schwartz had received for the mining properties as compared to the total amount of shares that had been issued in consideration of the conveyance of the mining properties to petitioner.

The purpose of requiring production of a company's books concerning which an auditor attempts to testify, is manifestly to give the opposing party an opportunity of checking and determining whether the testimony offered conforms with what is actually recorded. That purpose was definitely accomplished when petitioner offered to produce its entire permanent records which had been set up for it by the certified public accountant, whose testimony was rejected.

Respondent at the bottom of page 30 of his brief states that:

“Mr. Sandrich was not offering the taxpayer’s books and records pertaining to the transfer; he was offering his own audit papers, derived from taxpayer’s records during an audit made several years after the transfer occurred.”

Respondent, however, is not correct in this contention. The evidence without any question shows that the records which were offered had been adopted by the corporation as its permanent records after those records had been set up by a certified public accountant. Respondent concludes this point with the following contention and quotation from the authority cited in support thereof:

“The offer was to submit all of the papers without selecting those that were relevant to the transaction. The papers offered were incompetent and the nature of the offer was improper. Under the circumstances, the Tax Court had no choice but to reject the offer. No error was committed.

“The following statement of the Board of Tax Appeals, in *Evergreen Cemetery Assn. v. Commissioner*, 25 B. T. A. 544, 551, is particularly appropriate:

“The proper trial of a case before the Board requires thorough preparation, a clear understanding of the issues, and the marshaling of the evidence in such a way as to indicate clearly the effect of the same and the issue to which it appertains. This is not accomplished by dumping into the hands of the Board a number of books of account and other similar

evidence. Such evidence is not self-illuminating. The Board should not be asked to ferret out the correct answer to technical or difficult questions of law and fact from unexplained, uncoordinated evidence.' " (Resp. Br. pp. 30 and 31.)

Even the quotation above shows that in the cited case an entirely different situation existed. Here petitioner was not "dumping into the hands of the Board a number of books of account and other similar evidence." Petitioner was not asking the court to digest those records and obtain a proper answer therefrom. Petitioner was offering the services of a certified public accountant who had prepared those records and who as indicated by the question which we have quoted above was ready, able and willing to give "sum totals." The production of the entire permanent records of the corporation was made not for the purpose of proving by those records directly the ultimate fact in dispute, but as a foundation for the expert testimony of a certified public accountant. As held in the case of *Chicago Railway Equipment Co. v. Commissioner*, *supra*, the production of such books and records were a condition precedent to the introduction of the testimony of the certified public accountant concerning their contents.

We submit that respondent has wholly failed to justify the exclusion of this most valuable and competent evidence and testimony.

V.

**Respondent's Contention That the Tax Court Did Not Err in Denying Taxpayer's Motion to Re-open the Cause.** (Resp. Br. pp. 31 to 33.)

We have sufficiently discussed the question of the refusal of the witnesses Maxfield and Wilton to testify to which respondent first alludes in his argument under this point. The primary point that we wish to discuss is the illness of Mr. Steffes.

Respondent states:

“ . . . ; that in spite of the alleged ‘misfortune’ Mr. Steffes took quite an active part in the hearing, making no mention of his illness, and stating instead that he was appearing in the case because of the health of Mr. Sandrich [R. 100, see also R. 97]; . . . .”

We do not think that we owe an apology for not having included in the record some mention of the illness of Mr. Steffes. That illness was not caused by inaction but by the persistent refusal of counsel to stop working even though his physician had advised it. The collapse which took place the afternoon of the final day of the hearing was neither feigned nor unreal. We can only say that it is our sincerest hope that counsel for respondent who made the assertion above quoted, will not themselves be compelled to undergo the same effects which for more than one year followed thereafter.

Respondent refers to the “excusable neglect” in counsel’s failing to produce the documentary evidence in question. Counsel’s explanation for not having produced those documents was interrupted by counsel for respondent who immediately thereafter, as we have shown above, waived

all objections to the use of secondary evidence. Since the Tax Court restricted the proof to the one type of evidence that was not present in court, even though the production of that evidence was waived by counsel for respondent, petitioner should have been accorded the opportunity of producing that evidence. It is our sincere belief that if this hearing had been had in Washington where the Tax Court is in session at all times, a short continuance of the hearing would have been granted for the purpose of enabling petitioner to be heard on the merits. We make this statement with all due respect to the judge who presided at the hearing. His stay, however, in Los Angeles was limited, and undoubtedly the time allotted for that stay had already been completely allotted to other matters. We trust that the effects of this situation can and will be remedied by a proper order of this court.

The case of *Bankers Coal Co. v. Burnet*, 207 U. S. 308, 313, cited by respondent is not in point since there an entirely new point was attempted to be raised. The opinion requires no explanation to show the distinction which exists between that case and the present case.

The case of *Hughes v. Commissioner*, 104 F. (2d) 144, decided by this court, is likewise no authority for respondent's position. From what is stated in the opinion of the court the record did not disclose the basis of the court's ruling. It is our contention that each case must rest upon its own facts. Here there is no justification for the refusal of the Tax Court to grant a further hearing on this issue.

The case of *Scott v. Commissioner*, 117 F. (2d) 36, 40 (C. C. A. 8th) likewise relates to certain new facts which did not ever come "to the attention of the petitioner . . . or either of the petitioners in the two related cases until

some time subsequent to the Board's decision." A mere reading of the cited case discloses an entirely different set of facts and circumstances.

In the case of *O'Rear v. Commissioner*, 80 F. (2d) 473 (C. C. A. 6th) new issues were attempted to be injected into the proceedings by way of a motion to reopen the cause for further hearing. In the present case the original issue was the one upon which petitioner desired an opportunity to produce the evidence that was unavailable at the time of the hearing.

At the bottom of page 32 of his brief respondent cites the case of *Crane-Johnson Co. v. Commissioner*, 105 F. (2d) 740 (C. C. A. 8th) to the effect that "the taxpayer had its day in court." A similar statement was made in the portion of the brief of respondent contained on pages 23 to 25 thereof which we stated that we would answer at the conclusion of this brief. We shall, therefore, refer to and answer the former portion of the brief at this point and shall distinguish the cited case.

At the bottom of page 22 of his brief respondent states:

"The taxpayer was afforded a full and complete opportunity to present its case to the Tax Court and failed to do so. It is not entitled to a repeat performance in order that it may seek to remedy the mistakes of its counsel."

He cites the case of *Crane-Johnson Co. v. Commissioner*, 105 F. (2d) 740, 744 (C. C. A. 8th) affirmed 311 U. S. 54.

The situation in that case was entirely different from that existing here. The sole question there determined was whether the Board of Tax Appeals had abused its discretion in refusing a second hearing wherein the tax-

payer could be represented by an attorney, and where at the first hearing, the taxpayer was represented by a certified public accountant. The following language taken from the opinion discloses that the point was apparently abandoned by the taxpayer and the petition for review was prosecuted on more substantial grounds:

“In the list of points to be argued in petitioner’s brief appears the point that the Board should have granted the petition for rehearing. The matter is not referred to in the body of the brief and should probably be treated as abandoned. It is, however, referred to in certain briefs filed *amicus curiae*.”

No question was raised in that case and certainly none was argued that the taxpayer had not been accorded a full and complete opportunity to be heard at the hearing in which he was represented by the certified public accountant. The only question attempted to be raised was whether the certified public accountant, in appearing for the taxpayer, was engaged in the unlawful practice of law in the District of Columbia.

None of the questions involved there were involved here. Petitioner here was not afforded a full or complete opportunity to present its case to the Tax Court. As appears from a consideration of the entire record in this case, the petitioner was hedged in at every turn by objections made by respondent that were sustained by the Tax Court. As we have indicated above, the legal issue was so simple that it could have been determined in one of several ways. The means to supply this proof were available in court. Those means were rejected by the court and the proof was arbitrarily limited to a particular means that was not available at the time.

In closing the argument in his brief respondent suggests a comparison of the case last mentioned above, with the case of *Chatham Phenix Nat. Bank and Trust Co. v. Helvering*, 87 F. (2d) 547 (App. D. C.), cited by us in our opening brief. We ourselves particularly invite this court's attention to the statement of the humane principles set forth on page 550 of the opinion. We earnestly maintain that we have brought ourselves within the purview of the legal and equitable principles there set forth.

### Conclusion.

The decision of the Tax Court should be reversed with instructions to grant to petitioner a further hearing on the issue of depletion in the interests of substantial justice.

Respectfully submitted,

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*Attorney for Petitioner.*